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MONTANA FIRST JUDICIAL DISTRICT COURT, LEWIS & CLARK COUNTY

INVESTMENT COMPANY INSTITUTE, a Delaware Corporation, Plaintiff, vs. MONICA LINDEEN, STATE AUDITOR and Ex-Officio, Securities Commissioner of Montana Defendant.	Cause No. BDV 2010-1122 COMPLAINT FOR DECLARATORY JUDGMENT AND APPLICATION FOR ALTERNATIVE WRIT OF PROHIBITION

COMES NOW, PLAINTIFF INVESTMENT COMPANY INSTITUTE, a Delaware corporation and for its COMPLAINT against the DEFENDANT alleges as follows:

COUNT I

1. Plaintiff, Investment Company Institute ("ICI") is a national organization, composed of U.S. Investment Companies, including mutual funds, closed end funds, exchange traded funds (ETFs), and unit investment trusts (UITs). Collectively, members of the ICI have over 90 million shareholders. The ICI is a Delaware corporation with status as a tax-exempt organization under Section 501(c)(6) of the Internal Revenue Code. As part of its mission, ICI seeks to encourage

adherence to high ethical standards, promote public understanding and otherwise advance the interests of funds and their shareholders, directors, and advisors. It also engages with Congress and state and federal regulators on issues impacting mutual funds and their shareholders.

2. Prior to 1996, Montana and every state had authority to regulate the operations and offerings of mutual funds as well as to conduct inspections of mutual fund complexes and bring enforcement actions for any violation of state law. In 1996, Congress substantially limited this authority when it preempted state regulation of mutual funds with the enactment of the National Securities Markets Improvement Act of 1996 (NSMIA). In particular, NSMIA preempted all state authority over mutual funds with two exceptions. First, states could require mutual funds to make notice filings with and pay fees to the states. Importantly, however, these filings were just copies of the fund's federal registration with the SEC and were intended to alert the states to those funds that were offered for sale in the state. States do not have the authority to substantively review these filings or to deny any fund that makes such a filing the ability to sell its shares. Second, states have the right to investigate and bring enforcement actions with respect to fraud and deceit. This authority does not, however, authorize states to conduct routine inspections of mutual funds. To date the Plaintiff is not aware of a single enforcement action that the Defendant or her department have brought against a mutual fund issuer.

3. In 1997, the Montana Blue Sky Law (the "Law") was revised to conform its provisions and the authority of the Office of the State Auditor (the "State Auditor") under the Law to NSMIA. These revisions added a new Section 30-10-211 to the Law to govern mutual fund notice filings, which are referred to in the law as "federal covered securities." This new section, in part, requires issuers of mutual funds to make a notice filing with the State Auditor and pay the fee "prescribed in 30-10-209" of the Law. Subsection 30-10-209(1)(a) of the Law imposes a "fee of $200 for the first $100,000 of initial issue or portion of the first $100,000 in [Montana], based on

offering price, plus 1/10th of 1% for any excess over $100,000 with a maximum fee of $1,000." Subsection 30-10-209(c) provides that these fees must be paid annually so long as the mutual fund is offered for sale in Montana. Subsection 30-10-209(d) provides in relevant part that "[e]ach series, portfolio, or other subdivision of an investment company or similar issuer is treated as a separate issuer of securities. The issuer **shall pay a portfolio notice filing fee to be calculated as provided in subsections (1)(a) through (1)(c).** ..." [Emphasis added.] The level at which states assess mutual fund notice filing fees is a crucial determinant of the amount of fees paid. These fees may be assessed at: the prospectus level, meaning they are paid based on the number of prospectuses used by the issuer and not on the number of funds included within a prospectus; at the fund or trust level, meaning that each individual fund is assessed the fee; at the portfolio or series level, meaning that a separate fees is assessed on each portfolio or series within a fund; or at the class level, meaning that a separate fee is assessed on each class within each portfolio or series of the fund. Importantly, each class invests in the same "pool" (or investment portfolio) of securities and has the same investment objectives and policies as the portfolio it is a class of. The class structure is used to service particular distribution channels (e.g., a retirement channel versus a broker-sold fund channel) that invests in the same fund. Of the variety of ways states structure their fees, assessing fees at the class level is the most expensive. This is significant for mutual funds because state blue sky fees are paid out of fund assets. As such, the higher the fees that must be paid to the states, the greater the fund's expenses and the less the shareholders' return on investment. As noted above, in the two times since NSMIA was enacted that the Law was revised, the Law has continued to provide that mutual funds shall pay fees at the portfolio level.

4. On October 12, 2010, Lynn Egan, Deputy Securities Commissioner, acting on behalf of Defendant Monica Lindeen, Securities Commissioner of Montana, issued a letter to one of Plaintiffs member firms (attached hereto as Appendix 1) that states, among other things that:

> The Montana Securities Department will implement a change, effective January 1, 2011, with regards to investment company or similar issuers securities. Pursuant to Mont, Code Ann Section 30-10-209 (1) (d), "each series, portfolio, or other subdivision of an investment company or similar issuer is treated as a separate issuer of securities."
>
> In the past, the Department has required investment company and similar issuers to notice file or register securities to the portfolio level. The Montana Legislative Audit Division, as a result of a recent audit of this agency, has determined investment company and similar issuers must file to the class level." (Emphasis supplied).

5. The Commissioner's letter (Appendix 1) appears to be contrary to the express language of the Law, which provides that fees are assessed on each "portfolio" of federal covered securities. Indeed, the letter itself acknowledges, which is consistent with the language of the Law, that investment companies have been paying notice filing fees at the portfolio level. Notwithstanding the current and long-standing fee structure in the Law, the State Auditor seems determined, contrary to the statutory language, to impose a significant fee change on mutual funds through executive fiat. The stated rationale for this fiat is that the Legislative Auditor "has determined investment company and similar issuers must file to the class level." **A copy of the relevant portion of the report of the Legislative Auditor on which the Defendant relies is attached hereto marked Appendix 2.** Therefore, as of "January 1, 2011" the literal language of the Law is to be ignored without the input of the Montana Legislature and no opportunity for public debate or comment on this massive fee increase. This report of the Legislative Auditor makes note of the Department's past practice of collecting one fee on each series or portfolio, and interprets the applicable statute Section 30-10-209 (d) as requiring a "charge" on each "class" within a fund as a

"sub-division" of the fund while ignoring the statutory requirement to "pay a portfolio notice filing fee."

6. In ostensibly relying on the most recent opinion of the Legislative Auditor (Appendix 2) as a direct mandate, the Defendant Commissioner and her Department are summarily and arbitrarily abandoning years of past practice of enforcing the literal and "plain meaning" of Section 30-10-209 (d), M.C.A. They are also, however, ignoring the "re-enactment doctrine" which has been affirmed by the Montana Supreme Court, which requires the interpretation of a statute to conform to the manner in which has been applied in practice over many years of administrative application by the Department through re-enactment and amendment of the applicable statute. Under this doctrine, any change in interpretation necessitates a legislative re-enactment of the statutory provision in order to be effective. As noted above, the Law has been reenacted on at least two occasions since the enactment of NSMIA in 1996 and on each such occasion, no attempt was made to change the statutory basis for the fees as set forth in Section 30-10-209 (1) (d).

7. The Defendant's current attempt to increase mutual fund notice filing fees is not the first time the Defendant has attempted such action without obtaining the approval of the Montana Legislature. In 2003, the ICI was informed that the State Auditor intended to propose for public comment a revision to the rules under the Law. As revised, the proposed rule, Rule 6.10.147, would have imposed fees on mutual fund filers at the class level. At the time, the Plaintiff ICI opposed accomplishing this fee increase through a rule amendment on the basis that it violated Montana's Reenactment Doctrine and the Montana Constitution and was arbitrary and discriminatory. **A copy of written objections of ICI is attached hereto marked Appendix 3.** The ICI understands that, after it voiced its objections, the fee increase was not pursued. In contrast to the Defendant's 2003 attempt to increase mutual fund notice filing fees – which was attempted via a rule amendment – the current attempt is to accomplish this through executive fiat, thereby foreclosing any public comment

or discourse on this action. In addition, notwithstanding that the State Auditor knew of the ICI's interest in this issue from interactions between the Defendant's office and the ICI on a similar issue in 2003, the Defendant did not alert the ICI to its latest attempt to increase mutual fund notice filing fees.

8. Related to this issue is the level of fees collected from mutual funds under Section 30-10-209(1). With fees assessed at the portfolio level, pursuant to Section 30-10-209, mutual funds paid fees in excess of $2,433,455 for calendar year 2009. To put this amount in perspective, it bears noting that the Base State Budget for the entire Securities Branch of the State Auditor's office for Fiscal 2010 was approximately $832,000. In other words, under the *existing* fee structure, mutual funds pay almost 200% of the amount required to run the entirety of the Securities Branch of the State Auditor's office. And yet, this Branch is also charged with regulating – and collecting fees from – broker-dealers and investment advisers and their representatives as well as other issuers of securities. We are not aware of the Office attempting to increase the fees on these other registrants through executive fiat as they are attempting to do to mutual funds. And, as noted above, the State Auditor's jurisdiction over the mutual funds that must pay these fees is severely limited by NSMIA – which is not true of these other registrants subject to the State Auditor's authority. In other words, the mutual fund industry pays Montana over $2.4 million each year for Montana to record and file mutual funds' notice filing forms and cash the checks accompanying these forms. And, through executive fiat, the State Auditor is looking to collect even more fees for this minimal cursory regulatory role. Due to the limited amount of "services" the Defendant Montana Securities Commissioner performs in return for the fees levied with respect to these filings, the existing fee appears to be more in the nature of a tax than a cost of "services rendered". Black's Law Dictionary (4th Ed.) define a tax as:

A pecuniary burden laid upon individuals or property to support government, and is payment exacted by legislative authority. (NOTE: Appendix 2 refers to the failure to collect these additional fees as a "cost" to the General Fund.)

9. It seems clear, under the facts in this case, that the Defendant and her Department staff have (1) re-interpreted Section 30-10-209 to support imposing mutual fund notice filing fees as the "class" level rather than at the portfolio level notwithstanding that such action is contrary to: (i) the express statutory language; (ii) their long history of assessing fees at the portfolio level; and (ii) Montana's "re-enactment doctrine" of statutory interpretation, the Administrative Procedure Act and appropriate Legislative authorization. Moreover, they are proposing this change at a time when the actual fees paid by mutual fund issuers *annually* for many years far exceed the costs and expense of any necessary regulation by Defendant's Securities office over mutual fund issuers. Indeed, it appears that what is being attempted by the Defendant here, despite the other irregularities of the Defendant's decision, is clearly an attempt to impose a tax on Plaintiff's members and all mutual funds offered for sale in Montana. Such action would appear to be , beyond the Defendant's authority under the Law to impose fees.

COUNT II

APPLICATION FOR ALTERNATIVE WRIT OF PROHIBITION

10. ICI incorporates by reference paragraphs 1 through 9.

11. Pursuant to Article 3, Section 1 of the Montana Constitution, legislative and executive powers must be separated. The legislative power is entrusted to the Senate and the House of Representatives. The Defendant is a member of the executive branch pursuant to Article 6, Section 1 and is neither authorized to amend a statute which has been subject to a long-time interpretation and re-enacted without change several times since the original interpretation was

made, nor does it have the power to transform a FEE for services into a TAX by increasing the FEE far beyond any possible payment for services rendered.

12. Taxes may only be levied after the passage of a general law by the legislature. Montana Constitution Article 8, Section 1. The legislature's taxing power is inalienable and nontransferable. *Id.* at Article 8, Section 2. The executive branch of government is therefore prohibited from enacting new taxes and has no power or jurisdiction to do the same.

13. Defendant's proposed actions constitute the re-interpretation of a long-standing statutory policy and the imposition of a tax by the Defendant. The legislature has not authorized these actions. Defendant is therefore without the power or jurisdiction to make such an interpretive change or enact such a tax. Such acts are not ministerial in nature.

14. If the Defendant is allowed to institute this new tax, ICI's members as well as the public at large will suffer serious harm for which there is no plain, speedy, and adequate remedy in the ordinary course of law. Extreme necessity exists to prohibit the defendant from illegally enacting this new tax.

15. ICI therefore applies for an alternative writ of prohibition. Such writ is fair and proper under 27-27-101 *et seq.*, M.C.A. ICI requests that the Court promptly prohibit the Defendant from taking any action in furtherance of the illegal tax and asks that the Court set a hearing at a time before January 1, 2010, the date on which the illegal tax will begin to be levied. At the hearing, the Defendant should be ordered to show cause why the tax, if imposed, would not be illegal and assessed in excess of authority. ICI is further entitled to its costs and attorneys fees expended to stop the imposition of this tax.

WHEREFORE, ICI prays for judgment as follows:

1. For a declaration at law that the Defendant's proposed changes to the manner in which fees are imposed on mutual funds:

a. Would, if authorized, legally amount to an unauthorized increase in fees without compliance with the Montana Blue Sky Law, the Administrative Procedure Act or application to the Legislature for an appropriate change in the applicable statute, as well as the imposition of a tax and not simply an additional fee;

b. Would, if imposed, assess ICI's members as well as the citizens of the State of Montana with unauthorized fees, which would actually be TAXES, without the necessary legislative authority;

c. Would exceed the jurisdiction and authority of Defendant's office; and

d. Cannot legally be enforced.

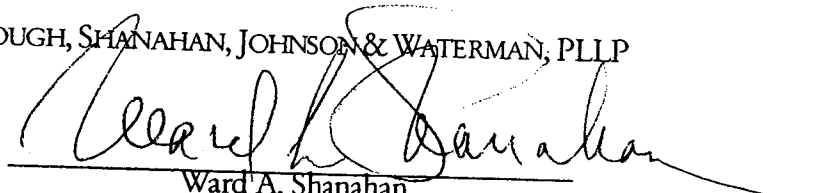
2. For an alternative Writ of Prohibition preventing the Defendant from taking any action in furtherance of Defendant's attempt to implement or apply the proposed tax.

3. For a permanent writ stopping the implementation of the illegal tax.

4. For ICI's costs and attorneys' fees, as well as any other remedy available to ICI.

DATED this 22nd day of November, 2010.

GOUGH, SHANAHAN, JOHNSON & WATERMAN, PLLP



Ward A. Shanahan
Attorneys for Petitioner

APPENDIX 1

COMMISSIONER OF SECURITIES & INSURANCE

MONICA J. LINDEEN
COMMISSIONER

OFFICE OF THE MONTANA
STATE AUDITOR

October 12, 2010

Raina Williams
Bny Mellon Asset Servincing
66 Broadway Ste 1
Lynnfield, MA 01940

Re: Notification requirements

Dear Raina Williams:

The Montana Securities Department will implement a change effective January 1, 2011, with regards to investment company or similar issuer's securities. Pursuant to Mont. Code Ann. § 30-10-209(1)(d), "each series, portfolio, or other subdivision of an investment company or similar issuer is treated as a separate issuer of securities."

In the past, the Department has required investment company and similar issuers to notice file or register securities to the portfolio level. The Montana Legislative Audit Division, as a result of its recent audit of this agency, has determined investment company and similar issuers must file to the class level. Therefore, beginning January 1, 2011, issuers will be required to notice file or register securities at the class level. New issuers and issuers renewing on or after January 1, 2011 must submit a new application for each class previously incorporated in a portfolio filing with multiple classes. If more than one class is included in a prospectus, the Department will require notification or registration of each class unless the issuer undertakes to "sticker" the prospectus notifying Montana investors of classes that are not available to Montana investors.

To facilitate filing and eliminate additional paperwork, the Department will accept and encourages investment company and similar issuers to file their Consent to Service of Process with the Department at the trust level.

If you have any questions regarding this filing requirement change, please contact April Fife at (406) 444-5236 or the undersigned at (406) 444-4388. You may also visit our website at www.csi.mt.gov for more information.

Sincerely,

Lynne Egan
Deputy Securities Commissioner

Phone: 1-800-332-6148 / (406) 444-2040 / Main Fax: (406) 444-3497
Securities Fax: (406) 444-5558 / PHS Fax: (406) 444-1980 / Legal Fax: (406) 444-3499
840 Helena Ave., Helena MT 59601 Website: www.csi.mt.gov E-Mail: csi@mt.gov

APPENDIX 2

A REPORT TO THE MONTANA LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

State Auditor's Office

For the Two Fiscal Years Ended June 30, 2010

OCTOBER 2010

LEGISLATIVE AUDIT DIVISION

10-20

of Revenue for collection. In fiscal year 2008-09, the office transferred uncollectable receivables for the Insure Montana program to the Department of Revenue but kept the receivable on the office's accounting records. This resulted in an understatement of nonbudgeted expenditures of $34,794 in the State Special Revenue Fund.

Default Fines

State accounting policy specifies that recognition of receivables should occur as soon as the underlying transaction occurs even if the resources are not yet received. This includes receivables in which the state has an enforceable legal claim to the resources that have not yet been received. Policy also specifies the corresponding revenue should be recorded in the period when earned, so long as receipt of cash is anticipated within 60 days of fiscal year-end. If receipt is expected to be delayed, the revenue should be deferred. In fiscal year 2009-10, the office did not record $49,251 of receivables in the General Fund for default fines in which the office had an enforceable claim. Since the office did not anticipate collecting these fines within 60 days of fiscal year-end, deferred revenue entry also should have been recorded.

RECOMMENDATION #1

We recommend the office implement internal controls to properly identify, capture, or exchange information in a form and time to prevent errors.

Noncompliance with State Law

The department did not comply with state laws regarding securities fees and excess deposits.

Securities Fees

Section 30-10-209, MCA, specifies the various security fees the office is required to collect from brokerage firms, investment advisory firms, and individuals working for those firms. Collectable security fees are defined as series, portfolio, or other subdivisions of an investment company. Currently the office only collects security fees at the series and portfolio levels. Other subdivision fees include classes of securities within each portfolio which the office is required to collect per state law. Noncollection of subdivision fees costs the General Fund an estimated $750,000 to $1,000,000 annually.

Excess Deposits

Section 33-2-609, MCA, limits the amount of assets or securities an insurer may have on deposit to no more than 20 percent or $50,000 of the required deposit, whichever is the larger amount, for the purpose of absorbing fluctuations in the value of assets and securities deposited, and to facilitate the exchange and substitution of such assets and securities. As of June 30, 2010, two of twelve insurers have deposits exceeding the permitted 20 percent excess threshold resulting in excess liabilities to the state of $118,774.

RECOMMENDATION #2

We recommend the office:

A. *Collect security fees at class levels as required by state law.*

B. *Retain assets or securities in amounts that do not exceed deposit thresholds as required by state law.*

APPENDIX 3

November 24, 2003

To: Karen Powell, Deputy Securities Commissioner
Montana Office of the State Auditor

From: Tami Salmon, Senior Associate Counsel

Re: Montana's Proposed Fee Increase for Mutual Fund Filings

The Institute understands that the Office of the State Auditor and Commissioner of Securities of the State of Montana (the "Commissioner") proposes to publish for public comment a proposed revision to its rules to require mutual funds to make notice filings and pay fees at the "class" level, rather than at the current portfolio/series level. For the reasons discussed below, the Institute strongly recommends that the Commissioner not proceed with this administrative action.

I. Background

A. Subsection 30-10-209(d)

As a condition of selling shares in the State of Montana, registered investment companies (mutual funds) are required to make filings with and pay fees annually to the Commissioner. The fees to accompany these filings are set forth in Section 30-10-209 of the Montana Code. Importantly, subsection (d) of this statutory provision provides in relevant part as follows:

> (d) Each series, portfolio, or other subdivision of an investment company is treated as a separate issuer of securities. The issuer shall pay a portfolio notice filing fee to be calculated as provided in subsections (1)(a) through (1)(c). . .

For purposes of this memorandum, it bears noting that the above excerpt of subsection 30-10-209 (d) has been reenacted in this exact same form at least two times – once in 1997 and, most recently, this year. (*See* Section 3 of Senate Bill 144, which was introduced at the request of the Commissioner and enacted on March 26, 2003.)

B. Mutual Fund "Classes"

By way of background, as used in the mutual fund industry, the term "class" is used to distinguish among groups of shareholders *in the same mutual fund* based either upon how the fees for the shares are paid by the shareholders or the services provided to the shareholders, or both. Each class of shares of a mutual fund portfolio or series will invest in the same investment portfolio of securities and will have the same investment objectives and policies as all other

classes of the portfolio or series. The security purchased by the investor represents a share of the fund's portfolio or series – irrespective of how the investor pays for such shares or the services provided to that shareholder – *i.e.*, irrespective of the "class" of security they purchase. In other words, the composition of the security purchased by the investor is determined at the portfolio or series level, and not at the class level. Today, approximately 19 states assess mutual fund notice filing fees at the class level. All other states assess fees either at the series/portfolio level, or at the prospectus level.

C. Montana's 1994 Policy Statement

On January 6, 1994, Mark O. Keefe, then Montana State Auditor and Securities Commissioner, published a policy statement letter that provided in relevant part as follows:

> Montana's 1993 legislature enacted amendments to the securities registration requirements of the Securities Act of Montana. Beginning on October 1, 1993, each series, portfolio, or other subdivision of an investment company or similar issuer, was treated as a separate issuer for registration purposes. Each series, portfolio, or other subdivision must register separately from the investment company or master fund. The registration fees will be calculated in accordance with § 30-10-209(1), MCA.
>
> ***Classes within a subdivision are not required to register separately unless:***
>
> a. Each class has a distinct securities portfolio; or
>
> b. The classes are filed under separate prospectuses; or
>
> c. The classes use dissimilar names which would make the registration status difficult to determine.
>
> [Emphasis added.]

Since its publication in 1994, the official position of the Commissioner as set forth in this policy statement has been relied upon by both the Commissioner's office and the mutual fund industry. Accordingly, since at least January 1994, mutual fund fees have been paid to the Commissioner's office at the series or portfolio level – not at the class level – unless fees were required to be paid at the class level as a result of conditions a-c of this policy statement.

D. Montana's Draft Revisions to Rule 6.10.147

The Commissioner is currently contemplating revising Rule 6.10.147, which governs notice filings by registered investment companies, to provide, in part, that "[i]f more than one class in included in an issuer's prospectus, the department requires notification or registration of each class offered in Montana." In its draft "Notice of Public Hearing on Proposed Amendment" (the "Notice") that accompanies this proposed revision, the Commissioner notes that the revision would bring "the agency rule in line with legislative intent, current industry practice and the evolving nature of the mutual fund industry." This draft Notice additionally notes, "[t]he change in language *may* require certain filers to pay increased costs to notice file or register securities at the class level." (Emphasis added.)

Contrary to these statements, we submit, based upon the discussion below, that this rule revision would *not* bring the Commissioner's rules in line with legislative intent, but rather, would be expressly contrary to legislative intent and jurisdiction. Nor would this change bring Montana's filing requirements in line with "current industry practice and the evolving nature of the mutual fund industry." As noted above, most mutual funds *do not pay fees at the class level in the majority of states*. Accordingly, by following the lead of the minority of states – not the majority – Montana's action would be contrary to current industry practice regarding the payment of state fees. Moreover, those states that assess fees at the class level have been doing so *prior* to the enactment of NSMIA in 1996 when states expended far more resources regulating the mutual fund industry because their authority to regulate mutual funds had not yet been preempted by Congress.

II. The Commissioner's Fee Increase Requires Legislative Action

The Institute respectfully submits, based upon Montana case law and the Montana Constitution, that the fee increase the Commissioner proposes to implement requires legislative action in order to be lawful.

A. Montana Case Law: The Reenactment Doctrine

In the case of *Hovey v. Department of Revenue* (203 Mont. 27, 1983), the Montana Supreme Court held that a state agency could not change a long-standing interpretation of a statutory provision by administrative reinterpretation. This is because, according to the Court, an agency's long-standing interpretation has "the force and effect of law due to the repeated enactment by the legislature, of the operative parts, without change." The Institute submits that the holding in *Hovey* would seem to have applicability to the Commissioner's currently proposed action. As in *Hovey,* the Commissioner and the mutual fund industry have been relying on a long-standing interpretation of Section 30-10-209(d) of the Montana Securities Act. Since the Commissioner issued its interpretation of this provision in 1994, this statutory section has been reenacted without change to the operative parts on at least two occasions – the most recent of which occurred earlier this year. Accordingly, it would appear that, if the Commissioner determines to change its interpretation, the Montana Legislature must first revise Section 30-10-209(c). Under the *Hovey* case, in the absence of such legislative revision, the Commissioner lacks the lawful authority to make this change through administrative action.

B. The Montana Constitution

According to Article VIII § 1 of the Montana Constitution, "[t]axes shall be levied by general law for public purposes." Inasmuch as the fee increase the Commissioner proposes to implement involves a tax, it must be enacted by the Legislature through general law and cannot lawfully be levied or increased through administrative action by an agency. .

According to a 2000 study by the U.S. General Accounting Office, in 1998, Montana's revenues from securities offerings and notice filings – the vast majority of which were paid by the mutual fund industry – were $3.3 million. In 1999, this amount was $3.6 million. As regards the amount spent by Montana to regulate *the entire* securities industry, the GAO Report found that in 1999, this amount was $530,000 – ***or a mere 8% of the revenues collected from the industry.*** In 1998, this amount was $512,634 (also 8% of the revenues collected that year). In other words, of all the monies paid annually by the securities industry to Montana, ***92% of these revenues are used for purposes other than regulating the securities industry.*** In other words, almost all of the monies raised under the Act are used to support general government and not to

regulate the securities industry. As such, these amounts are taxes and any revisions to them must occur through legislative action and not through agency rulemaking.

C. The Arbitrary and Discriminatory Nature of the Proposed Fee

The Institute additionally notes that, in order to be lawful, any taxes or fees assessed under Montana law cannot be imposed arbitrarily or unreasonably. As regards the Commissioner's proposed fee increase, we do not believe it meets this test. In support of this view we note that Montana is proposing a substantial fee increase on an industry over which Montana has minimal regulatory jurisdiction. In 1996, Congress enacted the National Securities Markets Improvement Act of 1996 ("NSMIA"), which preempted the authority of states to regulate mutual funds. Pursuant to NSMIA, since 1996, state authority over mutual funds has been limited to (1) processing cursory notice filings – which cannot be subjected to any substantive review or regulatory scrutiny and (2) bringing enforcement actions with respect to fraud and deceit against mutual fund issuers. As regards (2), the Institute is not aware of a single action the Department has brought against a mutual fund issuer.

It bears emphasizing that Congress only preempted state authority over some – but not all – issuers. Issuers of securities other than a "covered security," as such term is defined in NSMIA, remain subject to the full panoply of state regulatory authority. As such, unless otherwise exempt, they must file their offering documents with the Commissioner and obtain the Commissioner's approval prior to offering any securities for sale in the state. Also, unlike its jurisdiction over covered securities, the Commissioner retains the authority to routinely inspect and examine these issuers, and to promulgate rules and regulations governing their activities. As such, the cost of regulating these entities should substantially exceed the cost of regulating issuers of covered securities over which the Commissioner lacks the authority to review or comment on their offering materials, conduct routine inspections, or regulate their conduct. And yet, of all the issuers regulated by the Commissioner, ***the only issuers that would be required under the Commissioner's proposal to pay higher fees are those over which the Commissioner has the least jurisdiction and those that already pay the most fees under the Securities Act.*** All other issuers will be unaffected by this proposed increase. As such, the proposed increase appears to discriminate directly against mutual funds vis-à-vis all other issuers of securities. Such discrimination does not appear to be lawfully supportable or tolerable under Montana law.

Along these lines, it bears pointing out that the fee increases sought by Montana will not be paid by some corporate conglomerate. Instead, based upon the way mutual funds are structured, these increased fees, as with other fund expenses, will be paid by mutual fund shareholders. As such, Montana's proposed action will, in reality, be discriminating against mutual funds shareholders vis-à-vis other shareholders. Unlike holders of other securities regulated by the Commissioner, only the investment returns of mutual fund shareholders will be impacted by this proposed increase – owners of other securities regulated by the Commissioner will be immune from the impact of this increase. This is a significant consideration inasmuch as, at a minimum, Montana's proposed fee increase ***will more than double the fees most mutual funds pay to the State.***

For these reasons, the Institute strongly opposes the Commissioner's proposed action to increase mutual fund notice filing fees by rule amendment. To the extent the Commissioner

determines that the securities industry should continue to subsidize state government far in excess of its current contribution of approximately 92% of monies raised under the Montana Securities Act, it would appear that, in accordance with the *Hovey* case and the provisions of Article VII §11 of the Montana Constitution, the Commissioner must refer such recommendation to the Legislature for appropriate action. In our view, however, in light of his role as the protector of investors, the Commissioner should oppose any action that would adversely affect investors, such as the proposed fee increase. Instead of resulting in enhanced protection of investors, the proposed increase will instead discriminate against a class of investors – mutual fund shareholders – for purposes wholly unrelated to regulation of the securities industry or the protection of investors.

We appreciate your consideration of our views on this issue and would welcome the opportunity to discuss these issues with you in more detail.

Enclosures